



## COUNCILMEMBER DONNA FRYE

City of San Diego  
Sixth District

### MEMORANDUM

DATE: April 19, 2007  
TO: Honorable City Councilmembers  
FROM: Councilmember Donna Frye  
SUBJECT: KPMG Report on Internal Controls

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On March 16, 2007, City Councilmembers received KPMG's opinion letter of the 2003 CAFR. In that opinion KPMG referenced another report dated March 12, 2007, which contained their consideration of the city's internal control over financial reporting and their tests of the city's compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. That report, however, was not released with KPMG's opinion letter. On March 19, 2007, KPMG appeared at the meeting of the Audit Committee. Prior to the start of that meeting, I requested that KPMG provide me with a copy of the March 12 report referenced in their opinion letter. I was told it was not yet completed. I requested that they provide it to me and all other Councilmembers after its completion.

Yesterday, April 18, 2007, at the Budget & Finance Committee hearing I asked Mr. Goldstone and Mr. Levin if they had a copy of the March 12, KPMG report on internal controls. They responded that they did and I requested a copy. The report is attached to this memo for your information as well as the March 12, 2007 opinion letter from KPMG.

One of the reasons I bring this to your attention is that on April 23, 2007, the City Council will be asked to "receive and file" the 2003 CAFR. However, the discussion regarding the attached report is not scheduled until April 30 at a meeting of the Audit Committee. It is my belief that had I not requested this report, it would not have been provided to the City Council until *after* we were asked to "receive and file" the 2003 CAFR. I further believe that before this Council is asked to take any action on the 2003 CAFR that there be a public hearing and discussion about KPMG's internal controls report.

I would also like to bring to your attention an April 18, 2007 Report to the City Council (Report No. 07-065), which is also attached. The fact that the City Treasurer was not in attendance at the final DPWG meeting where the 2003 CAFR was reviewed also concerns me.

Thank you for your prompt attention to this matter.

Cc: City Attorney Michael Aguirre  
Independent Budget Analyst, Andrea Tevlin

DF/ks

**Independent Auditors' Report on Internal Control Over Financial Reporting  
and on Compliance and Other Matters Based on an Audit of Financial  
Statements Performed in Accordance with *Government Auditing Standards***

To the Honorable Mayor and Members of the City Council  
of the City of San Diego, California:

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of San Diego, California (City), as of and for the year ended June 30, 2003, which collectively comprise the City's basic financial statements and have issued our report thereon dated March 12, 2007 which includes an emphasis paragraph stating the net assets of the governmental activities, the business-type activities, the sewer utility, the water utility, the other enterprise funds, the internal service funds, the San Diego Convention Center Corporation, and the San Diego Housing Commission and the fund balances of the general fund, the other governmental funds, the pension and employee savings trust fund, and the investment trust fund have been restated as of June 30, 2002. Our report was modified to include a reference to other auditors. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Other auditors audited the financial statements of the San Diego Housing Commission, as described in our report on the City's financial statements. This report does not include the results of the other auditors' testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors.

**Internal Control Over Financial Reporting**

In planning and performing our audit, we considered the City's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the City's ability to initiate, record, process, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying Attachment I as item 2003-1.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not

necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we consider item 2003-1 described above to be a material weakness.

### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the City's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying Attachment I as items 2003-2, 2003-3 and 2003-4.

This report is intended solely for the information and use of the audit committee, management, and federal awarding and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

March 12, 2007

**City of San Diego**  
**Schedule of Findings and Responses**  
**June 30, 2003**

**Item 2003-1, Material Weakness in Internal Controls over the Financial Reporting Process**

The City prepares annually a Comprehensive Annual Financial Report (CAFR) which includes its basic financial statements. We found that the City had inadequate policies, procedures, internal controls and personnel to ensure that an accurate and reliable CAFR was prepared and reviewed on a timely basis. Indicators of control deficiencies included our identification of material misstatements, the restatement of previously issued financial statements, the ineffective oversight of the City's financial reporting and internal control by those charged with governance, an ineffective control environment, inadequate controls over the selection and application of accounting principles, inadequate controls over nonroutine and nonsystematic transactions, and inadequate controls over the period-end financial reporting process. Due to these deficiencies, we proposed numerous material corrections to the CAFR as of and for the year ended June 30, 2003, and the reported June 30, 2002 net assets have been restated to correct for numerous items totaling over \$1 billion.

Specifically, deficiencies were noted in the following areas:

- CAFR Preparation
- Pension Accounting
- Capital Asset Accounting
- Metropolitan Wastewater Utility
- Risk Management
- City Treasurer's Cash and Investment Pool
- Procurement
- Accounts Payable and Accrued Expense
- Human Resources
- Accounts Receivable
- Information Technology

*CAFR Preparation*

In order to prepare the CAFR, a thorough understanding of U.S. generally accepted accounting principles, most notably Governmental Accounting Standards Board (GASB) Statement No. 34, is required. We noted the following errors due to deficiencies in internal controls over the CAFR preparation process:

- There was an incorrect classification and presentation of various funds within the CAFR. This included incorrectly reporting San Diego Data Processing Corporation as an enterprise fund, San Diego Medical Services Enterprise as a discretely presented component unit rather than a joint venture, the City's 401K Plan as an agency fund, and City resources set aside for repayment of tax

anticipation notes as an agency fund. Additionally, the City incorrectly omitted an investment trust fund representing cash owned and interest earned by legally separate entities within the City Treasurer's investment pool and incorrectly reported the Centre City Development Corporation's defined contribution plan assets as a fiduciary fund even though such assets were not held by the City in a trustee or agency capacity.

- Various debt transactions were not properly recorded. For example, loan proceeds were recorded as revenue rather than as debt, e.g. SANDAG loan, certain debt and the related investments held with an escrow agent were not properly removed when such debt was defeased, bond issuance costs were incorrectly expensed instead of being deferred in accordance with GASB No. 34, accrued interest payable was incorrectly calculated at year-end, and an arbitrage liability was not recorded.
- The City did not properly recognize certain revenues when recognition criteria were met. Additionally, the City's calculation of deferred revenue in the fund statements incorrectly included notes receivable due from developers, one-time revenue received from the State, and working capital advances receivable.
- The City incorrectly included investments as part of cash and cash equivalents within the Statement of Cash Flows.
- Errors were made in recording various land held for resale parcel transactions and the City incorrectly reported land held for resale at cost instead of estimated net realizable value.
- Interfund transactions, e.g. purchases and sales of land, were not properly identified and recorded at the correct historical cost. Additionally, interfund transfers were incorrectly recorded as working capital advances.
- The accrual for compensated absences was not properly calculated at year-end and certain components (add-on pay and employer taxes) were incorrectly excluded from the calculation.
- PETCO Park leasehold improvements made by the San Diego Padres were incorrectly recorded by the City as contribution revenue. Additionally, the City's liability for the future conveyance of ballpark land parcels to the Padres was not recorded.
- Leasehold improvements on City owned property were incorrectly recorded as contribution revenue, e.g. Zoological Society of San Diego.
- Errors at component units (legally separate entities that are included in the City's CAFR) were repeated in the City's CAFR. For example, errors in the receivable for purchased service credits and the liability for DROP obligations (San Diego City Employees' Retirement System) and in recording an incentive payment received on a food and beverage contract (San Diego Convention Center Corporation) occurred within those entities and were not detected prior to being included in the City's CAFR.
- There was a lack of a formal process for management review and evaluation of the completeness and accuracy of financial statement note disclosures.

*Pension Accounting*

Statement No. 27 of the Governmental Accounting Standards Board, *Accounting for Pensions by State and Local Governmental Employers*, established standards for local government pension accounting. The statement requires the City to measure and disclose an amount for annual pension cost on the accrual basis of accounting, which starts with the calculation of an annual required contribution (ARC), based upon actuarial standards.

The City had a mechanism to set aside a portion of pension plan assets as “surplus earnings,” also known as excess investment earnings. The “surplus earnings” were used to fund a variety of additional benefits for employees, such as retiree health benefits, or to “fund” employee offset payments, i.e. picking up the employee’s share of contributions. However, the City did not consider these activities when calculating pension expense in its financial statements.

A similar scenario was recently illustrated in a GASB implementation guide, a portion of which stated:

A defined benefit pension plan administers a postemployment healthcare plan that is funded by “excess investment earnings” (investment earnings for a particular year in excess of the long-term investment earnings assumption used for actuarial valuation purposes). Excess investment earnings are credited to a plan net assets reserve account within the pension trust fund, from which a portion of the total cost of healthcare insurance coverage for retirees is paid.

Although in form the healthcare benefits are provided by the plan, rather than the employer, in substance it is the employer that supports the benefits through higher contribution requirements. Actuarial valuations of the pension plan, from which the funded status of the plan and the ARC are derived, include as a key assumption a long-term investment earnings (discount rate) assumption. The calculations assume that actual earnings will exceed the assumption in some years and fall short of the assumption in other years. If, however, an amount equal to the excess earnings on pension trust fund assets in good years is applied to provide an additional postemployment benefit other than pensions, the employer’s contribution in relation to the ARC for that year should not be regarded, for accounting and financial reporting purposes, as supporting the pension benefits only. Rather, the employer is in the position of supporting, directly or indirectly, two benefits.

Correcting for additional benefits and other pension accounting issues resulted in increasing the June 30, 2002 net pension obligation in the City’s government-wide financial statements by \$90.4 million.

Additionally, certain benefits, i.e. Corbett, were not included in the actuarial accrued liability disclosure as they were inappropriately defined as being “contingent.” Correcting this issue increased the actuarial accrued liability disclosure by \$55.9 million as of June 30, 2002.

### *Capital Asset Accounting*

We noted a number of errors in the City's financial statements due to deficiencies in internal controls related to capital asset accounting. For example:

- Assets which had been placed in service were not transferred from construction-in-progress to depreciable assets which resulted in a misclassification of reported capital assets and an underreporting of depreciation expense.
- Various projects where certain planning, pre-design, and preliminary costs had been incurred but the projects were later canceled or abandoned were not removed from the City's reported capital asset balances.
- During the implementation of GASB No. 34 in fiscal year 2002, the City was required to capitalize infrastructure assets for the first time. However, the City added certain assets during this process to its financial statements that were already recorded in its capital improvement program.
- Developer contributed assets were not being recorded as City assets, or were not being reported in the year in which the transactions occurred, which resulted in an understatement of capital assets in the City's financial statements.
- Various errors in book values or estimated useful lives of assets resulted in an increase in net capital assets reported in the City's financial statements.
- Errors in recording various parcels of land resulted in an increase of capital assets in the City's financial statements.
- Errors in recording retentions payable and trust accounts related to capital activity occurred.
- There was a failure to capitalize interest as part of certain asset acquisition costs.

### *Metropolitan Wastewater Utility*

Revenue received from the Metropolitan Wastewater Utility Participating Agencies was not reconciled to supporting information which resulted in a \$9.5 million overstatement of deferred revenue as of June 30, 2002. Additionally, Metropolitan Wastewater grants receivable were not reconciled to supporting information. Thus, errors occurring when subsequent grant receipts were reported as additional revenues were not detected.

### *Risk Management*

In the normal course of business, the City is a defendant in various litigation. Such litigation is primarily related to general liability and workers' compensation claims but also may include other various types of cases. The City is self-insured for general liability and workers' compensation and has recorded a liability, based on results of actuarial studies performed by an independent actuary, in the City's internal



service funds. In addition, the City may be required to establish an estimated liability (general litigation liability) for other litigation not covered under the self-insurance program. For the year ended June 30, 2003, we noted only limited communications between the Risk Management Office and the City Attorney's Office regarding outstanding case reserves and other litigation issues.

Additionally, the City incorrectly understated its workers compensation liability by \$64.9 million as of June 30, 2002 due to errors in its calculation methodology and incorrectly overstated its public liability claims by \$21.9 million as of June 30, 2002 due to the communication issues noted above.

#### *City Treasurer's Cash and Investment Pool*

The City's process for allocating interest and reconciling cash and investments was unduly cumbersome, lacked proper management review, and was not performed in a timely manner. During our procedures on cash and investments, we specifically noted the following:

- Although the City performed a three way reconciliation between the bank, the general ledger, and the Treasurer, the general ledger balance was difficult to determine.
- Only 33% of the accounts selected for test work were completed in a timely manner as defined to be 45 days by the City Treasurer's performance measures.
- Reconciling items remained outstanding for several months due to lack of communication between the Auditor & Comptroller's Office and the Treasurer's Office, and because reconciliations were not prepared in a timely manner.
- The interest allocation process did not go through management review and, consequently, errors were found in the allocation.

#### *Procurement*

During our review of the procurement functions, we noted the following deficiencies:

- Departments have the ability to procure non-engineering consulting services without the involvement of the Procurement Department. Additionally, there is no control in place to ensure that multiple services from the same consultant which exceed \$250,000 in the aggregate are approved by the City Council.
- We noted instances where the person who completed the manual receiving report for the receipt of goods could also be the same individual making the initial requisition.
- The City uses a PA2610 requisition form to purchase items from vendors when a blanket purchase order has been issued. However, we noted that there is no formal process to track the issuance of blank PA2610 forms. Once a purchase order has been issued, City employees in possession of the form could obtain goods and services directly from a vendor location, similar to a check.

### *Accounts Payable and Accrued Expense*

We noted that to record the accounts payable accruals as of year end, the City kept a parallel period open from July 1, 2003 to August 15, 2003. During the parallel period, for all disbursements greater than \$100,000 that related to the fiscal year 2003, the City accrued the expenditure at year end. All disbursements made subsequent to August 15, 2003 were recorded in fiscal year 2004, regardless of which year the services were received. Additionally, errors were noted related to utility bills which were being recorded on the cash basis.

### *Human Resources*

Upon the hiring of new employees, no review is performed to ensure that all pertinent documentation is included in the employee personnel file. We noted instances where employee files did not include all required and relevant employment documents.

### *Accounts Receivable*

We noted a number of deficiencies in internal controls related to accounts receivable accounting. For example:

- Subsidiary ledgers and supporting detail listings for the City's various types of accounts receivable are not reconciled to the general ledger.
- Estimated year end accruals are not properly analyzed and supported.
- There is no formal analysis performed to determine the adequacy of the allowance for uncollectible accounts.
- Estimated year end water and wastewater accruals for earned but unbilled (EBUB) revenue are not properly calculated. The basis of the EBUB accrual calculation uses current year billed amounts. However, a portion of these billed amounts are subsequently adjusted and credited and rebilled (credit and rebills) after year end. This methodology results in an overstatement of the year end EBUB accrual.

### *Information Technology*

Information technology at the City is antiquated and does not effectively support the CAFR preparation. Further, we found weaknesses in information technology related internal controls in the following areas:

- Lack of documented policies and procedures for information security

- Inadequate network and application password controls
- Inappropriate RACF (security software) administrator access
- Lack of formal process for adding/deleting users from critical systems
- Little control over the creation of unlimited vendor and contractor identifications
- Inappropriate user access of VOS (workers compensation claim system) applications in the Risk Management Department
- Lack of review of VOS exception reports in the Risk Management Department
- Inappropriate user access – FAMIS (fixed asset) application
- Lack of segregation of duties in the payroll/personnel departments
- Inappropriate system administrator access in the City Automated Personnel Payroll System (CAPPS)
- Inappropriate access to create vendors in OPIS (procurement system)
- Inappropriate access to modify user application security in the OPIS procurement system
- Inappropriate access to enter invoices in the accounts payable system
- Segregation of duties conflicts for procurement activities
- Inadequate application change control policies and procedures.

#### *Recommendation*

Although a number of changes in personnel and processes have been made from June 30, 2002 to the present, the City will need to continue to reorganize, improve and document its processes, and train its personnel in order to establish a system of internal control which can reduce to a relatively low level the risk that errors or fraud in amounts that would be material in relation to the financial statements would not be detected within a timely period by employees in the normal course of performing their assigned functions.

In addition, the City should implement the applicable remedial actions as outlined in the Mayor's August 24, 2006 responses to the Kroll Report.

#### *Views of Responsible Officials*

We agree. The City recognizes the need for an improved financial reporting control framework and as such, continues to construct a better financial reporting process. As part of this, the City has committed itself to implementing all applicable remediation actions outlined in the Kroll report. Most notably, the

City has begun the procurement process for a new financial accounting system (Enterprise Resource Planning System), implementation of this system, will result in overhauling the vast majority of the City's accounting practices.

**Item 2003-2, Violations of the Internal Revenue Code**

San Diego City Employees' Retirement System (SDCERS) operates as a retirement system trust fund under Section 401(a) of the Internal Revenue Code of 1986, as amended ("IRC"). As a plan qualified under Section 401(a), SDCERS receives tax exemption, pursuant to IRC Section 501(a), on monies accruing within the pension trust fund. The City may not have complied with the IRC in the manner in which it funds and administers healthcare benefits for employees. Between 1982 and 2005, the use of SDCERS Surplus Earnings to fund retiree healthcare benefits and the administration of the retirement healthcare program through SDCERS may have violated the qualification requirements of IRC Section 401(a) and IRC Section 401(h).

*Recommendation*

The City should implement the applicable remedial actions as outlined in the Mayor's August 24, 2006 responses to the Kroll Report.

*Views of Responsible Officials*

We agree. On June 22, 2006, Ice Miller LLP, SDCERS' tax consultant, filed a report titled "Exclusive Benefit and Prohibited Transactions - Retiree Medical Benefits (401(h) Account)" with the Internal Revenue Service (IRS). This report is one of the filings submitted on behalf of SDCERS in its participation in the IRS's Voluntary Compliance Program, supporting SDCERS' application to obtain a Tax Determination Letter as a qualified pension plan. SDCERS and the City expect to receive a final determination on this filing during the summer of 2007.

Several actions have already occurred to change the manner in which retiree healthcare benefits are funded. Effective July 1, 2003 (Fiscal Year 2004), the City ceased designating any portion of its Annual Required Contribution to a 401(h) account with SDCERS. In February 2005, after the remaining balance of the SDCERS 401(h) account was exhausted, the City began separately funding and paying its retiree healthcare benefit on a pay-as-you-go basis. Action is still pending with the City to amend the San Diego Municipal Code related to the definition and use of Surplus Earnings in the "waterfall".

In recognition of the upcoming reporting requirements imposed by GASB 43, the City is taking steps to create a long-term funding plan for a separate retiree healthcare trust that will use actuarially-determined rates.

**Item 2003-3, Violations of Law: Wastewater**

The Clean Water Act requires municipalities to structure their rates in a proportionate manner to ensure that each user pays his fair share. Although the Clean Water Act does not define proportionality, the State Water Resources Control Board, which promulgates regulations interpreting the Act, does, and it explicitly requires that certain measurements be included in the sewer rate structure. Because the City's rate structure for the ten-year period from 1995 to 2004 did not fairly allocate the significantly higher cost of treating wastewater discharged by certain industrial users, resulting in residential users subsidizing the rates of industrial ones by millions of dollars per year, the City's rates were not proportionate and thus may have violated the Clean Water Act's proportionality requirement.

Similar to the Clean Water Act, Proposition 218 also contains a proportionality component, requiring that fees imposed upon "any parcel or person as an incident of property ownership shall not exceed the proportional cost of the service attributable to the parcel." Although the issue is not settled, there is authority suggesting that Proposition 218's proportionality requirement applies to sewer charges, and, if so, the City may have violated this requirement.

#### *Recommendation*

The City should implement the applicable remedial actions as outlined in the Mayor's August 24, 2006 responses to the Kroll Report.

#### *Views of Responsible Officials*

We agree. The City has implemented a rate structure that is consistent with the guidelines of the State Water Resources Control Board and Proposition 218 requirements. Furthermore, the City has entered into a tentative settlement agreement to end a class action lawsuit regarding the matter; this will require proposition 218 noticing before becoming final.

#### **Item 2003-4, Violations of Securities Laws**

In November 2006, the Securities and Exchange Commission (SEC) entered an Order sanctioning the City of San Diego for committing securities fraud by failing to disclose to the investing public important information about its pension and retiree healthcare obligations. To settle the action, the City agreed to cease and desist from future securities fraud violations and to retain an independent consultant for three years to foster compliance with its disclosure obligations under the federal securities laws.

In issuing the Order, the SEC made the following determinations:

- The City failed to disclose that the City's unfunded liability to its pension plan was projected to dramatically increase.
- The City failed to disclose that it had been intentionally under-funding its pension obligations so that it could increase pension benefits but defer the costs, and that it would face severe difficulty funding its future pension and retiree healthcare obligations unless new revenues were obtained, pension and healthcare benefits were reduced, or City services were reduced.
- The City knew or was reckless in not knowing that its disclosures were materially misleading.

- The City made these misleading statements through three different means:
  1. The City made misleading statements in the offering documents for five municipal offerings in 2002 and 2003 that raised over \$260 million from investors. The offering documents containing the misleading statements included the "official statements," which were intended to disclose material information to investors, and the "preliminary official statements," which were used to gauge investors' interest in a bond issuance.
  2. The City made misleading statements to the agencies that gave the City its credit rating for its municipal bonds.
  3. The City made misleading statements in its "continuing disclosure statements," which described the City's financial condition and were provided by the City to the municipal securities market with respect to prior City bond offerings.

The City consented to the issuance of the Order without admitting or denying the findings in the Order. The SEC's investigation is ongoing as to individuals and other entities that may have violated the federal securities laws.

#### *Recommendation*

The City should implement the applicable remedial actions as outlined in the Mayor's August 24, 2006 responses to the Kroll Report.

#### *Views of Responsible Officials*

We agree, as stated above the City has consented to the SEC order, and as part of the applicable remediation, the City has already retained an independent monitor to oversee the City's compliance with and remediation of the issues identified in the Order.



KPMG LLP  
55 Second Street  
San Francisco, CA 94105

## Independent Auditors' Report

To the Honorable Mayor and Members of the City Council  
of the City of San Diego, California:

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of San Diego, California (City), as of and for the year ended June 30, 2003, which collectively comprise the City's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the City of San Diego's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the San Diego Housing Commission, a discretely presented component unit, which statements reflect total assets constituting 88% and total revenues constituting 82% of the aggregate discretely presented component unit totals. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for the San Diego Housing Commission, is based solely on the report of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the report of other auditors provide a reasonable basis for our opinions.

In our opinion, based on our audit and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of San Diego, California, as of June 30, 2003, and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in conformity with U.S. generally accepted accounting principles.



As described in note 23, the net assets of the governmental activities, the business-type activities, the sewer utility, the water utility, the other enterprise funds, the internal service funds, the San Diego Convention Center Corporation, and the San Diego Housing Commission and the fund balances of the general fund, the other governmental funds, the pension and employee savings trust fund, and the investment trust fund have been restated as of June 30, 2002.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 12, 2007 on our consideration of the City's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

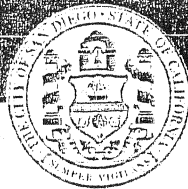
The accompanying management's discussion and analysis, schedules of trend information, and general fund budgetary information on pages 27 through 38, 184 through 188, and 191 through 194, respectively, are not a required part of the basic financial statements but are supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City of San Diego's basic financial statements. The introductory section, supplementary information, and statistical section are presented for purposes of additional analysis and are not a required part of the basic financial statements. The supplementary information, except for the budgetary schedules on pages 197 through 219, 234 through 235, 240 through 247, 250 through 251, 258 through 259, 261, and 272, has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole. The introductory section, the budgetary schedules referred to above, and statistical section have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

KPMG LLP

March 12, 2007





THE CITY OF SAN DIEGO  
**REPORT TO THE CITY COUNCIL**

RECEIVED

APR 18 2007

COUNCILMEMBER  
DONNA FRYE

DATE ISSUED: April 18, 2007

REPORT NO: 07-065

ATTENTION: City Council Members  
Docket of April 23, 2007

SUBJECT: Fiscal Year 2003 CAFR

REFERENCE: Municipal Code Section 22.0710, City Council Meeting 10/16/2006

REQUESTED ACTION:

Receive and file, the City's Comprehensive Annual Financial Report for the Fiscal Year ended June 30, 2003.

STAFF RECOMMENDATION: As above

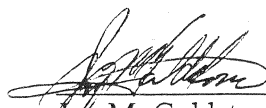
SUMMARY: Consistent with the remedial recommendation contained in the Report of the Audit Committee of the City of San Diego (Kroll Report) dated August 8, 2006, staff has provided numerous drafts of the CAFR to the City Council for their review and comment prior to the April 16, 2007 City Council meeting where this document will be discussed. At this meeting staff is recommending that it be received by the City Council as final. This document has been approved by the City's Disclosure Practices Working Group (DPWG) and the certificate of approval has been attached to this agenda item.

The public may obtain a copy of the City's 2003 CAFR on the City website at no charge.

FISCAL CONSIDERATIONS: None

PREVIOUS COUNCIL and/or COMMITTEE ACTION: October 16, 2006 Council Meeting

  
Greg Levin, Acting Deputy Comptroller  
Auditor & Comptroller

  
Jay M. Goldstone  
Chief Financial Officer

Attachment 1: Certification of the Disclosure Practices Working Group Regarding the March 13, 2007 FY 2003 CAFR

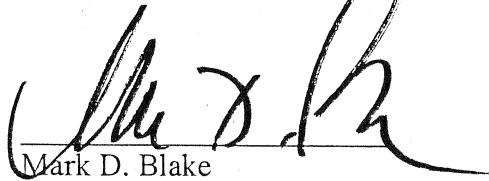
CERTIFICATION OF THE DISCLOSURE PRACTICES WORKING GROUP  
REGARDING THE MARCH 13, 2007 FY 2003 CAFR

The DPWG has reviewed, in accordance with Section 22.4107(a) (1) of the Municipal Code and the Disclosure Controls and Procedures adopted by the DPWG, the draft of the FY 2003 CAFR in the form presented at the DPWG meeting of March 13, 2007. In the best judgment of the DPWG, such draft, together with the additional revisions discussed at such meeting, is in substantially final form.

The final version of the FY 2003 CAFR will not be released to the public until (1) KPMG LLP has issued their signed audit opinion letter regarding the financial statements, (2) the written certification required by Section 22.4111(b) of the Municipal Code is executed and (3) the Council has received and accepted the FY 2003 CAFR.

The FY 2003 CAFR, when it is released in final form, will be accompanied by a certificate of the Chief Financial Officer and the Auditor and Comptroller to the effect that, to the best of their knowledge, the information contained in the FY 2003 CAFR fairly presents, in all material respects, the financial condition and results of operation of the City as of, and for, the periods presented in the FY 2003 CAFR and does not make any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading.

DISCLOSURE PRACTICES WORKING GROUP



Mark D. Blake  
Chief Deputy City Attorney

On behalf of DPWG\*  
Michael Aguirre, City Attorney  
Jay Goldstone, Chief Financial Officer  
Gail Granewich, Treasurer\*\*  
John McNally, Hawkins, Delafield & Wood LLP

cc: Jerry Sanders, Mayor  
Ronne Froman, Chief Operating Officer  
Andrea Tevlin, Independent Budget Analyst

\* The position of Auditor and Controller is currently vacant.

\*\* The Treasurer was not in attendance at the final DPWG meeting reviewing the 2003 CAFR. The Treasurer did review the 2003 CAFR in earlier meetings of DPWG on this subject.